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IN THE

Supreme Court of the United States

October Term, 1960

No. 376

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

—v.—

JERRY LESTER,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

Question Presented

The property settlement agreement between the taxpayer and his former wife provided that the taxpayer make periodic payments to his former wife of a large percentage of his gross income. These payments were to cease entirely upon the remarriage of his former wife regardless of the age, death or marriage of the children. The agreement also provided for a maximum payment to the wife which was also unchanged regardless of the age, death or marriage of the children. If the wife has not remarried, the agreement also provided for a reduction in the payment upon the emancipation, death or marriage of each of the children. It also provides for the wife to pay the taxes on the monies paid to her under the agreement. The question presented is whether this agreement fixes a portion of the periodic payment as "payable for" the support of the children within the meaning of Sections 22(k) and 23(u) of the Internal Revenue Code of 1939.

Statute Involved

Sections 22(k) and 23(u) of the Internal Revenue Code of 1939.

Statement

Jerry Lester and his former wife entered into a Separation Agreement on April 16, 1951. This agreement intended and provided that the wife was to pay the income tax on all monies received by her (R. 11, paragraph (d)). They were subsequently divorced, and the Separation Agreement was made part of the decree, and included therein. The Separation Agreement provides for payments to the wife of stated percentages of the husband's income (R. 10-11). The agreement further provides that all payments to the wife are to cease upon her remarriage, regardless of the ages of the children (R. 11, paragraph (i)). The agreement also provided that payments to the wife would be reduced by one-sixth in the event any of the children married, became emancipated, or died. Despite this percentage reduction, the maximum payments which the wife could receive were not reduced and remained constant. The agreement did not provide that any sum or portion of the payments to the wife was payable for the support of the children.

During 1951, Jerry Lester paid $23,000 to his former wife, and during 1952 he paid $39,000 to her. He deducted these payments on his income tax returns for those years under Sections 22(k) and 23(u) of the Internal Revenue Code of 1939. The Commissioner disallowed one-half of each deduction on the ground that that portion was payable for support of the children, although the agreement did not "fix any sum in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children * * *" (sec. 22(k) IRC 1939). This position was upheld by the Tax Court (R. 9-17), but reversed by the Court of Appeals (R. 19-25) in a well reasoned opinion by Judge Learned Hand, holding that the language of Section 22(k) plainly required that in order

to be treated as a payment for child support the agreement must fix a portion of the payment as support for the children, and that clearly the agreement here did not fix any portion as support for the children and therefore the entire amount of the payments was alimony and deductible by the husband.

Summary of Argument

Congress has provided in the Statute under consideration, Section 22(k), that in order for payments not to be treated as alimony the agreement must fix an amount or portion of the payment as being for the support of the children. It is clear that this agreement does not fix such an amount or portion, and that it is contrary to the intent and meaning of the Statute to attempt to read in such a fixing by reason of the fact that the amount of the payment is reduced when a child marries, dies, or reaches 21. Such a construction would defeat the purpose of the agreement which is to permit the mother to use and allocate the payments as she sees fit.

Furthermore, even if the Commissioner's position is upheld, that he can allocate the amount of such payments even where they are not specifically allocated, this case does not fall into that class of cases for the following reasons: even where there is an allocation, an intention to allocate must be shown, and the agreement under consideration here shows an intention not to allocate; where there is an allocation, the agreement must show a clear earmarking of amounts for support, and here there are varying provisions so that there cannot be said to be an allocation of an amount payable for support.

We submit that the reasoning of the Second Circuit was correct and should be affirmed, but even if this Court should disagree with that reasoning, the judgment below should be affirmed because this case is not one in which an allocation may be made even under the rule proposed by the Commissioner.

ARGUMENT

I. The Internal Revenue Code provides that for an amount of a periodic payment to be treated as payable for child support, it must be "fixed" by the settlement agreement as payable for that purpose.

Sections 22(k) and 23(u) of the Internal Revenue Code of 1939 are clear and unequivocal that payments to a former wife are alimony—reportable by the wife and deductible by the husband. The exception to this rule is where the agreement fixes a portion of such payment as being payable for the support of the children.

There is nothing in the Statute or the legislative history to suggest that Congress intended anything other than an exception where the amount was clearly allocated and set forth in the agreement. There is nothing to indicate that the Commissioner is free to decide that an amount is fixed for child support, when clearly it is not so fixed, by seeking to allocate amounts as payable for child support where certain payments may be reduced on the happening of specified events. As Judge Hand said in the opinion below (R. 23):

> "* * * That part of a 'periodic payment' that is not to be charged to the husband's gross income is only that which the 'written instrument' (shall) 'fix, in terms of * * * a portion of the payment, as a sum which is payable for the support,' etc. It by no means follows, because when a child dies or marries or reaches twenty-one the 'periodic payments' are diminished, that from the outset that child's support has been 'fixed' by the amount of the possible reduction. Indeed such a construction would defeat what is the basic meaning of such an agreement, for the mother is to be free to use her judgment in allocating the collective unit among her children and herself. It is true that it is assumed that she will use the payments to some extent to support the children, but we need not say that there could never be occasions when

> a court would overrule her discretion. In any case she is ordinarily free to allocate the payments as she thinks best, from time to time, spending on herself what she may think will in the end be for the best of the group. The fact that, when the group changes, the 'periodic payments' are reduced in a 'fixed' proportion does not indicate that meanwhile the wife's discretionary power has been limited. Indeed, we do not see why, if the existing allocation at the time of a child's death, marriage, or majority were to determine his proportion of the earlier payments, it does not follow that the wife's discretion is taken away altogether. Unless we have misapprehended its meaning, Congress intended to tax the wife on all the payments unless the agreement itself declared in what proportion she must allocate them to the children."

The argument of the Commissioner in its brief that Congress intended that an allocation should be made if the agreement "provided a means of designating" a portion of the payment as support (p. 8) and that he may allocate if "the instrument shows a sufficiently clear purpose to earmark or allocate" (p. 15) is simply not supported by the Statute. If Congress had intended to allow the Commissioner to allocate where he felt the agreement showed a "sufficiently clear purpose" it would have so provided. On the contrary it clearly provided that the agreement must "fix" such amounts for support. The agreement in this case clearly does not fix any amount for support of the children—it merely provides for alimony payments to the wife out of which she agrees to use an undeterminable amount to support the children.

As a matter of fact, the very language relied upon by the Commissioner in his brief, page 21, which was used to explain the Statute in the Senate hearings, illustrates that Congress conceived of the situation where an amount would be paid to the wife which would include support of the children without specifying any amount for their support, and

in that event "the entire amount goes into the income of the wife * * * ".[1]

Further, the report of the Senate Committee itself shows that it considered the situation where payments, whether directly or by trust, would be made to the wife for the support of herself and minor children without "specific designation," and in the following language it sets forth that the payments in that event are includible in the income of the wife:[2]

> " * * * If however the periodic payment and the trust income are received by the wife for the support and maintenance of herself and of minor children of the husband without such specific designation of the portion for the support of such children, then the whole of such amounts is includible in the income of the wife as provided in section 22(k) and in section 171."

Certainly if Congress intended the Commissioner to allocate where there was no "specific designation", or no amount was "fixed" in the agreement it would have provided so and not remained silent on the subject.

We respectfully submit that the Statute is clear and unequivocal and was correctly applied by the Court below since there was no allocation provided in the agreement, and to hold otherwise under the Statute would be the "disregard of plain language patently chosen with care" (R. 24).

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[1] " * * * If, however, that amount paid the wife includes support of children, but no amount is specified for the support of children, the entire amount goes into the income of the wife * * *." Senate Hearings, Revenue Act of 1942, 77th Cong., 2d Sess., p. 48.

[2] Senate Report No. 1631, 77th Cong., 2d Sess., p. 86.

II. The interpretation sought by the Commissioner will promote uncertainty, not certainty.

The Commissioner seeks to take upon himself the right to allocate payments to child support where the agreement itself does not made such an allocation. Thus, people who enter into such an agreement may not know the tax consequences for many years after the agreement is made. That many people have been caught in this trap is evidenced by the many cases on this subject and the many pending matters set forth by the Commissioner in his Petition for Certiorari. It seems apparent that they have relied on the wording of the Statute rather than upon Judicial decisions as contended by the Commissioner. This uncertainty would be avoided by the rule adopted by the Second Circuit, that is—where an agreement does not fix an amount as payable for child support the Commissioner may not allocate an amount to support by going over "the instrument with a fine-tooth comb to discover a figure which might be used as the basis for a division of the tax burden."[3] Thus, where parties have expressly fixed sums for support, they will be treated as such, and where no sums have been fixed, the Commissioner will be unable to allocate sums for support and frustrate the intention of the parties.

III. Even under the rule proposed by the Commissioner there would be no amount fixed by the agreement in this case.

A. There Was No Intention to Earmark any Amount for Support of the Children.

Even under the rule proposed by the Commissioner, he must find an intention to earmark a portion of the payments as support for the children before he can find such an earmarking.

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[3] *Weil v. Commissioner*, 240 F. 2d 584.

Here, there was clearly an intention not to earmark any portion of the payments as support for the children. Rather, the agreement clearly shows that the parties intended that the wife pay tax on all the money she received. This was done because she would get more money after taxes this way than if Mr. Lester were to pay tax on the money in a much higher bracket. In addition, the large percentage she received was based on his gross income—not his net income—so that it would have been financially impossible for him to pay the taxes with the amount of money he had left after paying his ordinary and necessary business expenses, which amounted to as much as 40% of his gross income. As a matter of fact one can easily foresee that the government itself would seek to overthrow such a situation where one gives away so much money that he does not have enough left to pay his tax.

Congress sought to avoid this result. In setting forth the purpose of the amendment to the Internal Revenue Code, the House Committee recognized that the former law did not allow a deduction to the husband for alimony payment, and that this result would work a great hardship in view of the high tax rates then being introduced.[4]

Furthermore, the agreement itself shows that it was the intention of the parties that Mrs. Lester pay the taxes on the money which she received. In paragraph 9 of the agreement, each agreed to file separate returns and pay his own tax. Further, in paragraph 11(d) (R. 20), it is provided that she receive a specified maximum amount after she pays the taxes.

Even the Tax Court at the trial recognized that the parties intended that there be no allocation and the wife pay taxes on all the money she received—but apparently

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[4] "* * * *. The increased surtax rates would intensify this hardship and in many cases the husband would not have sufficient income left after paying alimony to meet his income tax obligation * * *." House Report #2333, 77th Cong., 2d Sess., p. 46.

thought the Internal Revenue Code overrode that intention (R. 6). However, on the contrary, that Congress intended that the one who receives the money should pay the tax on it is shown by the House Ways and Means Committee in its report explaining the purpose and intent of the amendment as follows:[5]

> "These amendments are intended to treat such payments as income to the spouse actually receiving them or actually entitled to receive them and to relieve the other spouse from the tax burden upon whatever part of the amount of such payments is under the present law includible in his gross income."

It is therefore clear that there was no intention to fix any amount as payable for support of the children—but rather to pay one amount to the wife, she to pay the tax on the entire amount and assume support of the children, and that in such a situation Congress provided that the wife pay the tax on all of the money received by her.

B. The Cases Relied on by the Commissioner Hold That Only Such Amounts That Are Allocated for Support of the Children After the Remarriage of the Wife Are Not Deductible by the Husband. Here Since All Payments Cease Upon Remarriage of the Wife, They Are All Deductible by the Husband.

The rule sought to be applied by the Commissioner was established by the Tax Court. While in most of the cases, the amount of the reduction in payments was the same whether the reduction was on the wife's remarriage, or the children's marriage, emancipation or death, the Tax Court has clearly indicated that where there were reductions in different amounts for different contingencies, the amount of the payments which continued after the wife's remarriage would control. The rule was clearly set forth in *Fisher* v. *Commissioner*, 15 TCM 507.

In the *Fisher* case, the husband was required to pay $230 per month for the care, maintenance and support of

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[5] House Report #2333, 77th Cong., 2d Sess., p. 71. See similar language in Senate Report #1631, 77th Cong., 2d Sess., p. 83.

the wife and two children. After the children reach 21, he is obligated to pay $190 per month to the wife. If the wife should remarry prior to the children reaching 21, then the husband is obligated to pay $125 per month to support the children. The Court went on to say:

> "In considering the question of whether the separation agreement fixes the portion of the periodic payment as payable for the support of the children, the instrument must be construed as a whole. *We have held the amount set forth in an agreement for the support of the children upon the wife's remarriage represent the portion of the periodic payment that is payable for the support of the children, Robert Budd*, 7 T. C. 413 aff'd per curiam C. A. 6, 177 F. 2d 198 (38 AFTRA 549) *Beulah Weil*, 22 T. C. 612, *and cases cited.*
>
> "The question here is as to the portion of the $230 payment which the agreement earmarks as support for Samuel's minor children. *The sum which Samuel agrees to pay his wife after both children are no longer minors is unimportant.* As long as the children are both minors, the obligation is to pay $230 a month and the *remarriage provision identifies $125 of the monthly payment as children support.*" (emphasis added)

In the agreement under consideration, *all payments cease upon the remarriage of the wife, therefore, no part of the payments is identified as being for the support of the children*, and the entire amount is payment of alimony. As in the *Fisher* case, the amount by which payments are reduced when the children reach 21 is unimportant and does not indicate an allocation for support. It is the amount which is payable after remarriage which indicates an allocation for support, in our case this is nothing. Hypothetically, if our agreement provided that in the event the wife remarried, the husband were to pay $400 for the support of the children, then, under the rule of the *Fisher* case, the earmarking for support would be the $400 not the one-sixth by which payment was reduced when a child reaches

21. However, here it is provided that the husband pay nothing in the event the wife remarries, therefore, nothing is earmarked as support, and all the payments are alimony which is taxable income to the wife and tax deductible to Mr. Lester.[6]

It is interesting to note that this case, which presents the same issue as the present case in that there are different amounts allocated on different occasions is not cited by the Commissioner. However, all of the cases cited by him in his footnote on page 24 (except the three cases which were reversed),[7] stand for the ruling that the amount of the payment which the wife receives for support of the children after she remarries is the amount which may be held to be allocation for support prior to her remarriage.

Applying this rule to our case—since all payments cease upon the remarriage of the wife (paragraph i, R. 21) it is clear that there can be no allocation of monies as payable for support of the children prior to the remarriage.

C. There Are Varying Provisions for the Reduction of Amounts Payable Upon the Happening of Different Events.

The Commissioner seeks to reconcile *Deitsch* v. *Commissioner*, 249 F. 2d 534, *Weil* v. *Commissioner*, 240 F. 2d 584, cert. denied 353 U. S. 958 and *Hirshon's Estate* v. *Commissioner*, 250 F. 2d 497, with the rule he proposes on the ground that these cases contained varying provisions for

[6] We note that the Commissioner contended in the Court of Appeals that this view was rejected in the *Weil*, *Hirshon* and *Deitsch* cases *infra*. However he overlooked the fact that this is an alternating argument to the effect that if said cases are not approved, the agreement here would not contain an allocation even under the Tax Court ruling which he seeks to have this Court adopt.

[7] *Deitsch* v. *Commissioner*, 249 F. 2d 534, *Weil* v. *Commissioner*, 240 F. 2d 584, cert. denied 353 U. S. 958, and *Hirshon's Estate* v. *Commissioner*, 250 F. 2d 497.

reduction of payments, and hence it was not clear what amount could be allocated.[8]

If that be the rule, then it is equally unclear here for the following reasons: The payments are reduced by 1/6 upon the death, marriage or emancipation of each child, but they are stopped entirely upon the remarriage of the wife. Thus, if the wife remarried a month after the divorce the husband would have no payments to make even though all of the children were minors and unmarried. It is thus clear that there cannot be fairly said to have been a fixing of any amount as payable for support of the minor children.

That there is no amount fixed for support of the children is further shown by the fact that the agreement provides a maximum amount which the wife may receive regardless of whether or not the children are alive, married or emancipated—*i.e.*, $15,600 after the payment by her of taxes on amounts she receives (R. 20, paragraph 11(d)). Thus, if all of the children were killed in a disaster a month after this agreement was entered into, the wife would still receive the same amount of money as if they were alive.[9] Here again it is clear that there cannot fairly be said to be an allocation for support since she would receive the same amount whether or not she was supporting the children.

Therefore, if the *Weil*, *Hirshon* and *Deitsch* decisions *supra* are to be reconciled on the grounds of varying provisions, this case falls into the same category and the decision below should be affirmed.

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[8] Commissioner's Brief—p. 25, n. 27; p. 27, n. 26, 27.

[9] While the amount of each payment would be reduced, the maximum she could receive would be constant.

Summary

The decision by Judge Learned Hand is correct because the Statute provides that for an amount to be treated as payable for child support it must be "fixed" in the agreement, and no such sum was "fixed" in the agreement under consideration. Any other holding would leave taxpayers in a state of utter confusion and at the mercy of those interpreting the word "fixed".

Even if this Court accepts the rule proposed by the Commissioner, the judgment below is correct because no amount is fixed in this agreement even under that rule since (1) all payments cease upon the remarriage of the wife even though the children may be unmarried minors and (2) and the maximum amount she is to receive is never reduced by reason of the status of the children.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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